OUR DETERMINATION, OUR DESTINATION:
A 21ST CENTURY ECONOMY

Fiscal Year 2005 Executive Budget

In recent years, the state of Michigan has experienced difficult economic challenges. While these challenging times have required many tough decisions, they have also allowed us to reexamine the role state government plays in our quality of life and in improving our job growth.

During her first year in office, Governor Jennifer Granholm has governed with the belief that our spending must align with our priorities, and our priorities with our principles. She continues to follow these convictions in this balanced budget proposal for fiscal year 2005.

Throughout this difficult year, the Governor has engaged the great citizens of this state in a dialogue about the role state government should play. People strongly believe that our government must be fiscally responsible while providing a high quality of life for its residents; exceptional educational opportunities for young and old; affordable health care services; protections for our most vulnerable; and a clean environment. It should come as no surprise that job-creating businesses seek the very same things from state government.

A high quality of life cultivates a healthy business climate, and a robust economy cultivates our ability to deliver quality services to the people of Michigan. The two go hand-in-hand. Governor Granholm's balanced budget proposal for 2005 is based on these principles and serves as a framework for achieving our critical, shared goal -- growing jobs and economic strength in Michigan.

ECONOMY

Michigan's economy continues to suffer from the effects of a prolonged national economic slowdown. While the U.S. economy shows tentative signs of improvement, the manufacturing sector traditionally is slower to recover than other sectors of the economy. With little focus on restoring manufacturing strength nationally, the national economic recovery has been slow to reach Michigan. Michigan has lost some 300,000 jobs in the last three years, a disproportionate share of the nearly 2.4 million jobs lost in the nation during this time.

IMPACT OF FEDERAL POLICIES ON MICHIGAN FOR FY 2005	($ in millions)
Loss of Enhanced Medicaid Funds	$168
Phase-out of Michigan Estate Tax	$161
Loss of Medicaid Special Financing	$153
Federal Tax Law Changes	$74
Federal Mandate -- Medicaid Actuarial Rates	$67
Loss of Reed Act Funding	$51
Loss of Federal Funding -- Youth Prison	$18
TOTAL Impact	**$692**

While the national economy continues to place great strain on state budgets, federal fiscal policy is also contributing to the fiscal woes of the states. The Center on Budget and Policy Priorities estimates that changes in federal tax and spending policy have cost states $185 billion since fiscal year 2002, while federal fiscal relief for the states has totaled only $20 billion. While Governor Granholm will continue to work with the state's Congressional delegation to ensure that Michigan receives its fair share of federal dollars, her 2005 budget is based on current federal policies and does not assume any new federal fiscal relief.

In the face of these twin problems, a continuing economic slowdown and costly shifts in federal fiscal policy, states have turned to a variety of measures to solve their fiscal crises. Reserve funds have been drained, services have been slashed, programs have been reorganized, employees have been laid off, and major taxes have been raised. According to *The Fiscal Survey of the States*, 13 states enacted sales tax increases; nine states increased personal income taxes; eight states increased corporate income taxes; two states increased motor fuel taxes.[1]

Michigan, in contrast, remains committed to preserving critical services for citizens while keeping the cost of living and doing business in Michigan competitive. During the last year, we eliminated a $3 billion deficit with a combination of spending cuts, fee increases, increased tax enforcement, federal fiscal relief, and the sale of surplus property. As Governor Granholm stated in her State of the State message, "If you seek a leaner government, look about you." We have the lowest number of state employees since 1974. General fund revenues are the lowest since 1970, while at the same time we are providing services to 1.3 million more citizens than we did 34 years ago.

"It isn't hard to assess Jennifer Granholm's leadership. Her first year as Michigan's governor was defined by a $3 billion hole in the state budget. The governor met the challenge. She reached out to Michigan residents. She laid out the financial crisis and sought their help in choosing what programs and services should be cut."

Port Huron Times Herald, January 29, 2004

A recent study by the Tax Foundation indicates that Michigan's current tax structure compares very favorably with our economic competitors.[2] The study concludes that Michigan ranks 18th in the country for favorable tax climate towards business. The respected organization also ranks the state 29th in state and local tax burden as a percent of income. These numbers prove that taxes are not driving people away from Michigan, and that we are an attractive state to families and businesses.

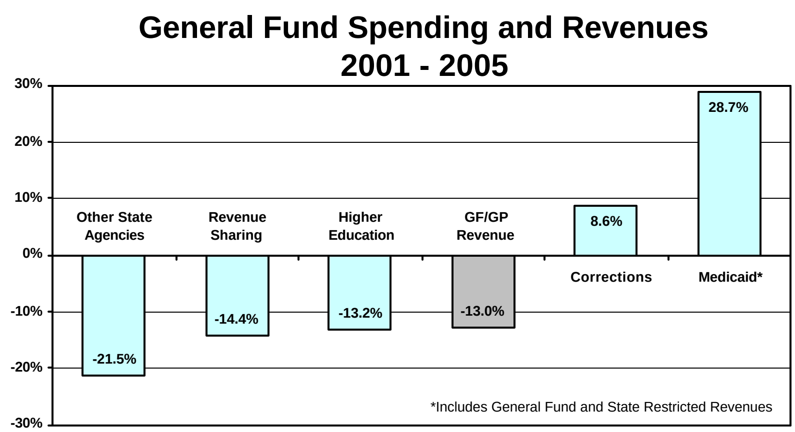
1 The Fiscal Survey of the States, (12/03)
2 Tax Foundation (5/03)

Governor Granholm is determined to preserve this favorable tax climate and believes Michigan must find a way to solve the budget crisis without turning to the general tax increases other states have pursued. She is committed to maintaining a tax structure that can bring new investment and new jobs to Michigan. She is determined to balance our budget with a combination of spending cuts and revenue enhancements that will make Michigan even more competitive in the years ahead.

REDUCING SPENDING

Since the state's economic slowdown began in 2001, state government has solved $5.7 billion in general fund revenue shortfalls by cutting nearly $2.4 billion in spending. Since Governor Granholm took office, over $1.4 billion has been cut to make up for the lack of general fund revenue. Many of these cuts have been tough decisions -- decisions that were terribly painful to make. We had to choose between what was important and what was vital.

The cuts already enacted affect virtually everyone in this state in some manner. The following are just a few of the difficult choices that have been made over the last few years:



- Since 2001, revenue sharing payments to local units of government have been reduced $482 million.
- Funding for institutions of higher learning has been cut $296 million.
- Adult education funding has been reduced by 75 percent.
- A decline in School Aid Fund revenue triggered a statutory requirement to reduce K-12 spending by $74 per student in 2003 and 2004.
- Non-emergency health care services such as dental, podiatric, and chiropractic for healthy adults were suspended.
- State employees have made tremendous sacrifices over the past year. Early retirements and hiring freezes have meant workloads have increased dramatically. State employees helped reduce the state's budget deficit by accepting over $200 million in payroll reductions.
- Due to early retirements and the hiring freeze, there are over 8,000 fewer state employees today than there were four years ago.

- Funding for the arts community was cut in half, which meant less grant money for local symphonies, art galleries and museums.

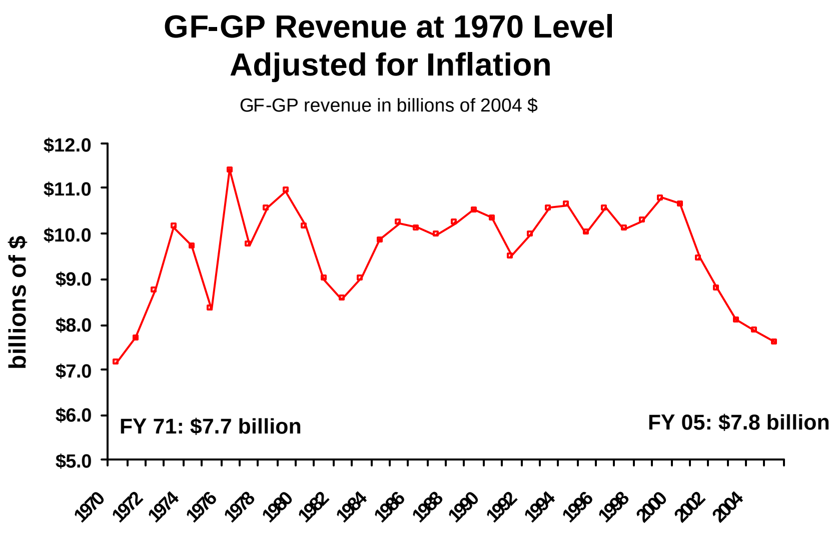
- Since 2001, state agency general fund budgets have been trimmed by over 21 percent, a larger percentage reduction than either revenue sharing or higher education.

While these cuts were painful, Governor Granholm used the budget challenges as an opportunity to create a leaner, more efficient government. Governor Granholm has done the following to save $350 million in administrative costs: calling in cars from the state's fleet, not filling vacant positions, curbing travel costs, reducing cell phone use, conserving energy in state buildings, reducing color copying and printing, canceling subscriptions, eliminating pay for performance bonuses, selling surplus state land, reviewing contracts and rental agreements, and much more.

Regrettably, Michigan is confronted with yet another general fund revenue shortfall – projected to be $1.3 billion for fiscal year 2005. Governor Granholm's focus has been to protect education for our children and services to our most vulnerable, while at the same time maintaining a high quality of life in order to grow jobs and our economy.

REVENUES

State law requires two revenue conferences per year. The conferees include the State Treasurer and the Directors of the House and Senate Fiscal Agencies. The conferees agree upon baseline revenue estimates for the current year and the upcoming fiscal year for both the general fund and the School Aid Fund. The conferences are held in mid-January and mid-May. The January conference provides the estimates upon which the Governor's budget recommendation is based. The May conference provides an opportunity to review the January estimates before final legislative action on the budget.



Over the last few years the revenues have continuously fallen below the estimates upon which the budget was based. When general fund revenues fall below the estimates upon which the budget is based, the Governor is required by the Constitution to submit a budget reduction proposal to the appropriations committees. In the last 14 months alone, three Executive reduction orders were presented to and approved by the appropriations committees in order to address mid-year revenue shortfalls. In both fiscal years 2003 and 2004, similar revenue shortfalls in the School Aid Fund triggered automatic reductions in school aid payments of $74 per student.

The 2005 general fund revenues are estimated at $7.8 billion, almost $2 billion less than actual 2000 revenues. When adjusted for inflation, general fund revenues are the lowest since 1970.

OVERALL BUDGET

The overall budget proposed by Governor Granholm for fiscal year 2005 totals $39.7 billion. The recommendation includes $12.5 billion for the School Aid Fund, $8.7 billion general fund, $1.1 billion for revenue sharing payments to local governments, and $3.3 billion for transportation needs. The spending priorities in this budget reflect the input the Governor received from the citizens of this state. Even though the budget reflects nearly $500 million in spending reductions, it protects our quality of life and it will strengthen our ability to grow good jobs.

Despite these tough economic times, the Governor is committed to quality education at all age levels including early childhood, K-12, and higher education. Over $14.5 billion, or 37 percent, of the 2005 budget is spent on education. The K-12 proposal restores the foundation allowance to $6,700 and the higher education budget honors the Governor's commitment to restore funding to those colleges and universities that exercise tuition restraint.

The general fund spending plan totals $8.7 billion. Over 80 percent of the general fund budget is spent in four areas: Corrections, Higher Education, the Department of Community Health (DCH) and the Family Independence Agency (FIA). The two budgets primarily responsible for protecting our most vulnerable citizens (DCH and FIA) account for $3.6 billion, or 42 percent, of our general fund spending, and $14.1 billion, or 36 percent, of our total budget.

The budget also recognizes close to $11 billion in federal revenues that are spread throughout many of the state's programs. Examples include: $4.2 billion in Medicaid, $1.1 billion for transportation needs, $1.3 billion for K-12, $1.1 billion in federal food assistance benefits, a $775 million welfare block grant, and almost $800 million in federal economic development and employment services funding.

GENERAL FUND

FUNDING GAP

The funding gap for fiscal year 2005 is estimated at $1.3 billion. This figure is based on a revenue gap of almost $400 million and unavoidable spending pressures exceeding $900 million. The revenue gap is simply the difference between the general fund revenue estimate of $8.4 billion and the current year expenditure base of $8.8 billion.

FY05 GENERAL FUND REVENUE GAP	($ in millions)
FY05 Consensus Revenue Estimate	$7,823
Base Revenue Not Included in Consensus estimates	
Bad Driver Assessments	$122
Revenue Sharing freeze	$355
Driver License Fees	$25
Increased Tax Audit	$85
Escheats Law Change	$15
Subtotal Base Revenue Not Included	$602
TOTAL FY05 Revenue Estimate	$8,425
FY04 Current Law Appropriations	$8,813
FY05 REVENUE GAP	**($388)**

FY05 FUNDING GAP	($ in millions)
Unavoidable Spending Increases	
Medicaid	$447
Family Independence Agency	$25
Corrections	$44
Labor & Economic Growth: Work First	$51
Debt Service	$51
Pension Contribution	$112
Employee Salary and Wages	$101
Employee Insurance	$33
Higher Education--tuition restraint restoration	$52
Subtotal Unavoidable Spending Increases	$916
FY05 Revenue Gap	$388
TOTAL FY05 FUNDING GAP	**$1,304**

The spending pressures involve the increased costs of funding existing programs according to current policies and statutes. Medicaid alone accounts for $447 million of the unavoidable spending pressures. Other spending pressures include increased caseload costs in the Family Independence Agency, full year funding for new prison capacity opened in the current year, increased debt service obligations, higher education tuition restraint pledges, collectively-bargained employee salary adjustments, state employee pension contributions, and the loss of federal Reed Act support for the Work First program.

The spending pressures are not entirely caused by actual spending increases but, rather, almost half represent a shift in costs from the federal government to the state. For instance, $454 million is directly attributable to federal mandates or the loss of federal support in Medicaid, Corrections and the Work First program.

Medicaid shortfalls include the loss of federal fiscal relief, the loss of federal funding for special financing transactions, new federal requirements regarding the actuarial soundness of our managed care programs, the inability to obtain statutory approval for a pharmacy provider tax, and a significant increase in caseload and utilization. These cost increases are partly offset by a $67 million increase in our federal matching funds. The dollar values are detailed in the accompanying chart.

FY05 MEDICAID SHORTFALLS	($ in millions)
Loss of Federal Fiscal Relief	$168
Loss of Federal Special Financing	$153
Caseload and Utilization Increases	$106
Federal Actuarial Soundness Requirements	$67
Pharmacy Provider Tax Shortfall	$19
Federal Matching Funds	($66)
TOTAL Medicaid Shortfalls	**$447**

THE OVERALL SOLUTION

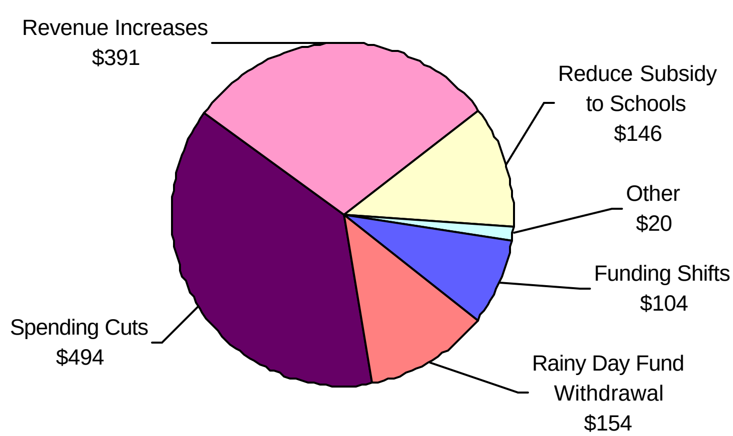
In developing the current year budget, the Governor and the Legislature made a good faith effort to reduce the reliance on gimmicks and one-time fixes. The sudden windfall of $655 million in federal fiscal relief last summer allowed us to set aside $150 million in reserves, but also increased our reliance on one-time revenue. Within a few months, it became evident that the revenue estimates upon which the original 2004 budget was based were overly optimistic. The Executive Order spending reductions and the income tax pause in December brought the current year back into balance. Unfortunately, the use of remaining reserves once again added to our structural problems.

The Governor is committed to addressing the structural budget shortfall. The only way to fulfill this commitment is to adopt permanent revenue enhancements and spending reductions.

The Governor's budget closes the $1.3 billion funding gap with an appropriate mix of solutions. The mix includes $494 million in spending cuts, $391 million in revenue enhancements, a $146 million reduction in the general fund contribution to the School Aid Fund, redirection of $154 million in cigarette tax revenue to Medicaid instead of the Rainy Day Fund, $64 million associated with the shift in the Merit Award payment schedule, and $40 million in other fund shifts.

A Balanced Approach to Solving the General Fund Problem

($ in Millions)



The spending reductions include $184 million from the suspension of county revenue sharing payments, $70 million in the Department of Community Health, $76 million in employee-related savings, $65 million by eliminating private tuition grants, $49 million in other agency reductions, and $50 million in School Aid Fund cuts. The county revenue sharing proposal is really a five-to-twelve year pause in the state's obligation and involves moving counties' property tax collection from the winter to the summer, generating almost $1.4 billion in county reserves. The counties would then place those revenues in reserve and draw down an amount equivalent to their annual revenue payment each year until the reserves are fully depleted. Once an individual county's reserve is depleted, their revenue sharing payments will be restored.

REVENUE ENHANCEMENTS

In order to find permanent solutions to the Medicaid and general fund structural problems, the Governor's budget includes $391 million in new revenues. The revenue proposals include a 75-cent increase in the cigarette tax, decoupling from the federal estate tax, and an increase in the liquor mark up from 65 to 74 percent.

Under the Governor's proposal, the tax on a pack of cigarettes will increase from $1.25 to $2.00, generating $295 million in new revenue. The Governor's proposal deposits the first $30 million into the Healthy Michigan Fund for smoking cessation and chronic disease programs. The remaining $265 million is deposited into the Medicaid Benefits Trust Fund, offsetting a portion of the lost federal revenue.

Michigan's estate tax is equal to the maximum allowable federal credit for estate and inheritance taxes. Due to changes in the Internal Revenue Code in 2001, the Michigan estate tax is scheduled to be gradually phased-out over four years. In fiscal year 2000, the estate tax generated $180 million. Over the last few years, the state's budgets have reflected the phase-out of this tax. Absent any changes, the fiscal year 2005 budget would lose another $45 million.

The Governor is proposing that Michigan join 18 other states and the District of Columbia who have already decoupled from the federal estate tax. The Governor's proposal would generate $94 million in fiscal year 2005 and $130 million on a full-year basis. The proposal applies to deaths after July 1, 2004, and includes a filing threshold of $1 million, with exclusions for family-owned farms and businesses. With these changes, the estate tax would impact only 1,600 estates per year, approximately 1 percent of filers in Michigan. The revenue would be deposited into the Medicaid Benefits Trust Fund.

The estate tax is an existing Michigan law and these proposed changes actually increase the filing threshold that was in place before the federal phase out began in 2001. The phase out of the federal estate tax is not a permanent tax cut since it expires in 2010. The proposed changes to Michigan's law, however, would permanently put in place the exemptions for family-owned farms and businesses, as well as increasing the filing threshold.

The Governor is also proposing an increase in the mark-up applied to liquor sales. The Liquor Control Commission establishes uniform prices for the sale of alcoholic liquor. The commission then applies a mark-up, or gross profit margin, of not more than 65 percent. The profits are deposited into the Liquor Purchase Revolving Fund. The Governor's recommendation is to allow the Liquor Control Commission to increase the mark-up to 74 percent. The increase would apply only to liquor, not beer or wine. The first call on the increase in profits would be to fully fund local fire protection grants. The remaining profits would increase general fund revenues by $32 million.

SCHOOL AID

Fiscal year 2005 School Aid Fund revenues, estimated at nearly $11 billion, exceed general fund revenues of $7.8 billion by over 40 percent. Additional earmarked school aid revenues of $35.2 million are anticipated from enhanced tax collection enforcement and other minor revenue adjustments. As a result, the general fund subsidy to the School Aid Fund can be reduced to $132 million without jeopardizing funding for local schools. Federal funds of $1.3 billion bring the overall school aid budget to nearly $12.5 billion, approximately $104 million more than the pro-rated fiscal year 2004 budget.

The fiscal year 2005 school aid budget fully funds a minimum foundation allowance of $6,700 per pupil — a level that had been promised by the past Administration, but never achieved. Districts with declining enrollments are assisted by a return to the 50/50 blending of prior year and current year pupil counts used when Proposal A was implemented. Those districts with foundation allowances equal to or greater than $9,000 per pupil continue to be paid at the reduced 2004 pro-rated level.

Additionally, the budget provides over $1.2 billion ($906 million state funds) for special education services and over $740 million ($314 million state funds) of supplemental support to improve student achievement.

The Governor's *Project Great Start* for preschoolers includes an expansion of the Great Parents, Great Start program operated by intermediate school districts for all children from birth to age five. Funding is increased from $3.3 million to $10 million for programs that encourage positive parenting skills, promote early literacy, and mitigate the need for special education services. Intermediate school district funding is reduced by $6.7 million to pay for this increase. In addition, $85 million provides preschool opportunities for over 25,000 four-year-olds.

"When stuck with a massive budget deficit, with little indication that the nation's sluggish economy will rebound anytime soon, the governor had no choice but to make some tough decisions, even if it meant that many special interest sectors would be hit hard. We applauded Granholm for keeping her promise to spare education from significant budget cuts."

The Macomb Daily, June 4, 2003

The Governor's *Learn to Earn* initiative announced in her State of the State message is funded in the school aid budget by earmarking $1 million of matching funds for grants to intermediate school districts. The districts will develop plans to open *Learn to Earn* Centers for students who have dropped out of traditional high schools. These specialized high schools will focus on providing students an environment that integrates academic knowledge with experiential learning opportunities in order to prepare for careers of their choice. Funding for traditional vocational education programs is also maintained at $39 million, as well as adult education at $20 million.

HIGHER EDUCATION

The focus of the Governor's higher education budget is to keep Michigan's public higher education institutions accessible and affordable during these difficult economic times. Her fiscal year 2005 budget for universities, community colleges, and student financial aid totals over $1.9 billion.

In December 2003, the Governor and the Legislature agreed to a reduction plan that reduced operational spending by 5 percent. Those universities and community colleges that pledge not to increase tuition and fees for the remainder of this academic year, and not to increase 2004-2005 tuition and fees above inflation, will have 3 percent of their base funding restored. The Governor's budget recommendation honors that commitment. Those universities and community colleges that do not accept the tuition restraint pledge will have their state aid reduced by another 3 percent. The funding in the 2005 budget for higher education is based on the assumption that all universities and community colleges will accept the Governor's challenge to hold down tuition and fees.

"The National Center for Public Policy and Education says that at least 250,000 people were priced out of a college education in 2003. Granholm's deal seeks to mitigate that trend - forcing universities to accept a smaller than expected budget hit in exchange for inflation-based tuition increases. It's a creative compromise that colleges and universities should embrace."

Lansing State Journal, February 6, 2004

Unfortunately, Michigan can no longer afford to subsidize tuition for private institutions. The fiscal year 2005 budget eliminates $65 million for tuition grants available only to students attending private institutions. Remaining student financial aid programs totaling over $130 million are maintained. Nearly all of these financial aid programs are accessible to students who attend both private and public institutions.

HEALTH CARE

The Governor acknowledged in her State of the State message that "few things affect the quality of our life and the quality of our work more than our good health." To that end, in fiscal year 2005, Michigan will invest $9.8 billion in health care and health-related programs, including over $3 billion in state funds. These funds support health coverage for low-income families and individuals, provide mental health services throughout the state, and fund a range of prevention and education programs.

Medicaid is a joint federal-state program that provides health coverage for over 1.3 million residents of Michigan. Unfortunately, that federal-state partnership is broken. The federal government is increasing mandates on the state, and significantly reducing its financial commitment to the program, at a time when the state is least able to absorb the costs. Enhanced federal matching funds helped states weather the recession in 2003 and 2004; even though our Medicaid caseloads are still at record levels, those funds will not be available in fiscal year 2005. In addition, the federal government is eliminating special financing arrangements, costing the state over $150 million next year and an additional $150 million in 2006. Compounding the problem, the federal government is requiring increases in reimbursement rates for managed care organizations – which will cost Michigan over $67 million next year — at the same time that they are withdrawing funding for the program. These combined federal actions require the addition of over $385 million in state funds to the Medicaid program. The state must identify a stable revenue source to replace the lost federal funds.

"Increasing health care costs and the growing number of people living in poverty as a result of the weak economy have created record-level spending on the health insurance program for the low-income residents."

Lansing State Journal, October 25, 2003

As discussed earlier, the Governor recommends a 75-cent per pack increase in the cigarette tax. Because smoking leads to increases in health care expenditures, the Governor also recommends that this funding source be dedicated to health care. When approved, the cigarette tax increase will provide almost $265 million in direct, ongoing support for the Medicaid program.

The Governor also proposes that a portion of the tax ($30 million) be invested in smoking cessation and preventative health programs. Studies show that increases in the price of cigarettes are most likely to deter teenagers from smoking. In a recent report, the National Academy of Sciences, Institute of Medicine concluded that "The single most direct and reliable method for reducing consumption is to increase the price of tobacco products . . . "[1] Studies suggest that a 10 percent increase in the real price of cigarettes will reduce cigarette consumption by 3 - 5 percent overall and 6 - 7 percent in children.[2] Based on these averages, a 75-cent per pack tax increase would mean 60,000 fewer adult smokers and 94,000 fewer minor smokers in the state.[3]

1 National Academy of Sciences' Institute of Medicine (1998); "Taking Action to Reduce Tobacco Use."
2 National Center for Tobacco-Free Kids (2002); "Raising Cigarette Taxes Reduces Smoking, Especially Among Kids."
3 National Center for Tobacco-Free Kids (2003); "State Cigarette Taxes & Projected Benefits from Increasing Them."

In addition to increasing the revenues supporting the Medicaid program, the Executive Budget also includes various proposals to reduce program costs. The proposals have been crafted to minimize the impact on recipients of health care, while reducing costs by over $100 million gross, $70 million general fund. These cost containment proposals include increased efforts to secure reimbursements from responsible third parties, reductions in pharmacy-related costs, increases in vital records fees, and changes in the nursing home payment policy for temporary hospital stays.

Funding for mental health services is recommended at $2.3 billion in 2005, an increase of 4 percent over current year levels. This funding includes a rate increase of $29 million, $13 million general fund, to ensure that payments to mental health providers are actuarially sound in accord with federal requirements.

Services to Families and Children

When Governor Granholm took office, she made a commitment to protect Michigan's families. This budget follows through on that promise by providing funding for critical "safety net" programs and dedicating resources to services and initiatives that improve the lives of children.

The budget funds anticipated caseload increases for the Family Independence Program, which provides a monthly cash assistance grant to approximately 78,500 low-income families, and dedicates resources for employment services to help these families achieve economic independence. The Governor also proposes a budget of $518 million for day care services, so that children can be cared for while their parents work, search for a job, or further their education.

Families receiving support from the Family Independence Program currently receive an annual allowance of $40 per child to purchase clothing for their school-aged children. The Executive Budget provides another $3.1 million to extend this clothing allowance to *all* children receiving cash assistance, and to increase the annual payment to $50 per child.

Governor Granholm further recommends $114 million for Welfare-to-Work programs for our state's neediest citizens. Additional Temporary Assistance for Needy Families (TANF) funds of $11 million and additional general fund revenues of $40 million replace federal Reed Act money, which was rescinded by the federal government. These funds will be used to provide employment and training services to public assistance recipients.

The Governor's budget also provides $83 million to aid workers who have lost employment due to job losses resulting from the North American Free Trade Agreement.

Besides providing income assistance, work support, and food benefits for low-income families, the Executive Budget supports a variety of service programs including foster care to protect children who cannot remain safely in their own homes, adoption subsidies to assist special needs children in achieving permanent homes, and family services to preserve and reunify troubled families. Juvenile justice services are also provided to delinquent youth referred to the state for placement and supervision.

The Children's Action Network, initiated by Governor Granholm last year, brings together state and local agencies to work collaboratively to better support Michigan children. The Family Independence Agency is the lead agency to implement an important initiative of the Children's Action Network – an effort to improve human service delivery through school-based family resource centers. To date, 20 full-time family resource centers have been opened in "high priority" neighborhood schools, bringing assistance directly to the families that need them. Building on this successful model, 20 more family resource centers will be opened in the coming year, within existing budgetary resources.

GROWING OUR ECONOMY

In Governor Granholm's State of the State message, she presented a blueprint that will allow Michigan to become an economic powerhouse by attracting and retaining good jobs. Many of the Governor's initiatives begin with the newly created Department of Labor and Economic Growth. This centralized and streamlined "one-stop" agency will focus on job creation, workforce development, and economic growth. The consolidation of these functions allows our state to position itself as one of the most nimble and business-sensitive states in the nation.

In cooperation with the Michigan Economic Development Corporation, three new financial tools are being created to help businesses take root in Michigan and grow new jobs at every stage of development—the Emerging Business Fund, the Venture Michigan Fund, and the Small Business Growth Fund. Although no new state funds will be required to support this initiative, the creation of these financial tools sends a strong message to entrepreneurs and businesses that we stand ready to help grow business and create new jobs here in Michigan.

The Executive Recommendation maintains funding of $15 million for the Technology Tri-Corridor, which is a catalyst for research, development and commercialization in high-tech areas.

TRANSPORTATION

More than at any time in its history, the Department of Transportation is partnering with local stakeholders and the public to create a collective vision for the future of transportation in Michigan. This vision includes not only the roads we drive and the bridges we cross, but also the integral network of transit, rail freight, marine, and aviation services that together so directly impact the quality of life for residents and visitors alike. Governor Granholm's recommended transportation budget for fiscal year 2005 totals $3.3 billion, a 6 percent increase over the current year.

Highlighting the Governor's budget recommendation is an additional $26 million for local critical bridge repairs resulting from the re-direction of one-half of one-cent of the state gasoline tax currently dedicated to state trunkline bridge repairs. Along with adding resources, the Governor is also firmly committed to critical bridge program reforms that will place an emphasis on preventive maintenance and rehabilitation to ensure dollars are cost-effectively invested and the overall local bridge system is improved.

"Granholm's Preserve First program is the only sensible course for a strapped state whose roads are among the nation's worst."

Detroit Free Press, June 17, 2003

The re-authorization of the federal Transportation Equity Act of the 21st Century (TEA-21) continues to be a priority for Governor Granholm and a broad coalition of interest groups who seek to return a "fair share" of federal transportation dollars to Michigan. Congress has temporarily extended the authorization of TEA-21 through the end of February 2004. Michigan's transportation program relies on over $1 billion in federal aid each year, and is not well-served by delays in determining long-term resource allocations. Governor Granholm strongly supports the expedient passage of a new six-year transportation bill that rectifies our state's donor status and returns a minimum of 95 percent of federal funds to Michigan for highways and public transit.

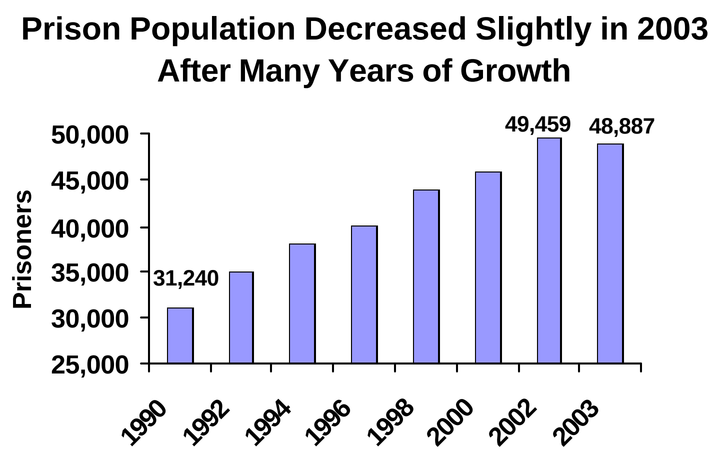
PUBLIC SAFETY

CORRECTIONS

The Five-Year Plan to Control Prison Growth has had a positive impact on a burgeoning prison population. The number of prisoners under the Department of Correction's control declined in 2003, marking the first decline since 1983. The prison capacity benefits that have been derived through the early successes of the Five-Year Plan will lead to the closing of the Western Wayne Correctional Facility near Plymouth during fiscal year 2005. This older, less cost-efficient facility will be closed, with prisoners shifted to a newer facility in Ypsilanti that is currently underutilized.

Further success with the Five-Year Plan requires continued action. As part of the fiscal year 2005 Executive Recommendation, Governor Granholm recommends modifications in sentencing guidelines to bring probation violators into the guidelines structure, and to make adjustments to sentencing guidelines for certain crime classes. The changes do not effect Michigan's Truth-In-Sentencing statutes. The state will continue to work within the existing Community Corrections framework to reinvest in criminal justice options at the local level.

A significant spending pressure for the department in fiscal year 2005 is the replacement of federal funding that has ended. The Executive Recommendation includes $18 million in general fund replacement for federal Violent Offender Incarceration/Truth-In-Sentencing (VOI/TIS) funding. Since fiscal year 2000, the state has utilized over $100 million in VOI/TIS funding for various prison construction programs, as well as operations funding at the Youth Correctional Facility. The fiscal year 2005 general fund increase will support continued operations of this 480-bed facility located in Lake County.



The Executive Recommendation also includes a $14 million adjustment for operation of 965 prison beds in the Jackson prison complex. The beds were previously operated with the support of work project funding that is no longer available.

The Department of Corrections continues its active efforts to control costs with over $29 million in specific general fund reductions included in the fiscal year 2005 Executive Recommendation. Savings initiatives include optimizing the inmate transportation system, security adjustments, prisoner health care savings, and consolidation of certain administrative functions, among other reductions.

HOMELAND SECURITY

Homeland security and critical public safety services are top priorities in the Governor's budget. New federal homeland security funds in the departments of State Police and Military and Veterans Affairs will be used to detect, prepare for, protect and respond to any threats of violence to the residents of the state. In total, this budget includes over $60 million to support homeland security efforts and $52 million to address bio-terrorism threats. The budget also includes capital outlay funding to consolidate facilities for the Department of Military and Veterans Affairs into a secure, centralized location in North Lansing to better respond to national and state emergencies.

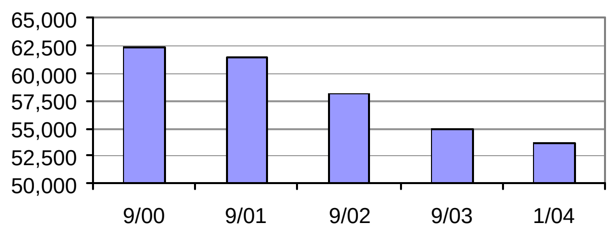
The Governor's commitment to the safety of our families is exhibited in the fiscal year 2005 budget for the Michigan State Police. The budget supports completion of the 100-candidate state trooper school, which will begin late in fiscal year 2004. The trooper school will bring trooper strength to an acceptable level of 1,100. The budget also includes an additional $1 million to help reduce the DNA analysis backlog so that criminals can be brought to justice as soon as possible. Over $30 million is recommended for improvements to state and local emergency 9-1-1 dispatch centers.

Employee-Related Economic Cost Increases

The Governor has repeatedly expressed her gratitude and admiration for the employees of our state government. These are stressful times for employees who are doing their work with over 8,000 fewer co-workers than just four years ago, while at the same time accepting significant reductions in their take-home pay. Despite their hard work, frugality, and pay cuts, Michigan is still waiting for our economy to improve.

As part of her proposal to resolve a projected shortfall in the fiscal year 2004 budget, the Governor asked state employees to be part of the solution to the state's budget crisis; she asked for their assistance, cooperation, and suggestions. They stepped up to the challenge and worked cooperatively with the Office of the State Employer.

Change in Classified Employees September 2000 to January 2004



The end result was that the State Employer and the unions negotiated employee concessions consisting of furlough days, banked leave time, and increased medical co-pays that, together with similar adjustments for non-union employees, contributed over $200 million worth of savings to the fiscal year 2004 budget. Employees paved the way for other savings with voluntary work schedule adjustments and by helping to reduce our dependence on costly outside contractors.

For the most part, the cost saving measures that protected the 3 percent pay increase and that addressed other employee-related cost increases are in place for only the current year. Therefore, the 2004 employee salary and fringe benefit costs must be accounted for in fiscal year 2005. In addition, most state employees are scheduled to receive a 4 percent pay increase in fiscal year 2005, at a total estimated cost of $112 million, $60 million general fund.

Equally significant, the required contribution to the state's pension systems will increase by over $204 million, $112 million general fund, due to a substantial boost in unfunded accrued liability in the state's defined benefit pension system. The unfunded liability is attributable to the pension system investment losses in 2000 and 2001, coupled with the impact of the 2002 early retirement package. And, as is happening in every sector of the health care system, employee health insurance costs in 2005 will be 13.6 percent higher than in 2003.

In total, in order to fully fund employee salary, pension, and insurance costs, the budget needs to increase by over $458 million, $247 million general fund. Obviously, the state cannot afford to fund the entire increase in one fiscal year. Therefore, although the 2005 budget includes full funding for employee-related economic increases, further employee-related savings will be required.

The Governor is determined to preserve the fiscal year 2004 three percent base pay increase and to make possible the scheduled 4 percent pay increase. To achieve this important goal, we must again look to our employees to help us identify and implement budgetary savings. The total value of the necessary savings is $148 million. We will be asking state employees to work with their agencies and with the Office of the State Employer to identify these savings, which may be found again in reducing our dependence on wasteful outside contracts, promoting voluntary work schedule adjustments and, regrettably, to some extent through continuation of a portion of the temporary wage and benefit concessions.

The magnitude of this necessary savings adjustment is significant, but with focused efforts underway to work with state employees to reduce the cost of outside contracting, any wage and benefit adjustments for fiscal year 2005 should be limited to banked leave time, and the 4 percent base pay increase should be protected.

Revenue Sharing

The state provides unrestricted financial support to over 1,800 units of government and allows them to determine how they may make the best use of their financial resources.

The financial support comes in the form of revenue sharing payments, which are comprised of a constitutional and statutory obligation. This budget recommends over $1.1 billion in payments to cities, villages, and townships. The constitutional obligation for fiscal year 2005 is $692 million and is dispersed on a per capita basis. The remaining $443 million, which is subject to appropriation, is recommended in this budget.

For fiscal year 2005, overall revenue sharing payments for cities, villages, and townships are equivalent to the fiscal year 2004 spending level. Governor Granholm proposes that a portion of these funds be used for payments-in-lieu-of-taxes to local units of government for lands owned by the Department of Natural Resources. Revenue sharing appropriations will pay an estimated $7.5 million for these tax obligations in 2005. The remainder of revenue sharing funds will be distributed as unrestricted financial support to local units of government.

Under this proposal, tax payments for these properties would no longer be financed from the general fund, Game and Fish Fund, Waterways Fund, and Natural Resources Trust Fund. The resulting savings for the fee-supported funds can be reinvested in conservation and recreational activities more consistent with the purpose for which the fees were originally collected.

For fiscal year 2005, Governor Granholm recommends an alternative to county revenue sharing payments. Under this proposal, the county property tax levy will be permanently shifted from December to July each year. Counties will receive additional revenue of $1.4 billion as a result of changing the tax collection schedule. Counties would hold these funds in reserve to be annually expended during years in which state revenue sharing payments are suspended.

Suspending county revenue sharing payments for fiscal year 2005 allows more than $180 million to be redirected to other areas of the state budget. An equivalent amount would be available in each of the next five years. A county would become eligible for renewed revenue sharing payments when the county's funding reserve is less than the county's suspended revenue sharing payment.

Conclusion

Since Governor Jennifer Granholm took office, she has been committed to reducing the historic gap between state spending and state income. This "structural imbalance" threatens the stability of the overall state budget which, in turn, threatens the state's ability to protect its quality of life and attract new businesses. In her budget proposal for the current fiscal year, Governor Granholm worked to solve the structural shortfall with a combination of fee increases, accounting measures, and painful spending reductions. She deliberately avoided additional cuts because there was no consensus to do so.

"But we continue to maintain that government services are an important component of quality of life in any state or community. The argument that businesses are being driven away from Michigan by taxes just doesn't hold water anymore....It's possible that the day could come when companies won't come to Michigan because of its ruined roads, closed parks, decimated schools and other examples of damaging neglect."

Kalamazoo Gazette, January 25, 2004

Today, we must collectively ask how much further we can cut without sacrificing the quality of life that is critical for both our residents' and our businesses' well-being. We must put politics aside and recognize that in order to solve the remaining budget shortfall, permanent revenue fixes must be part of the overall solution. These revenue solutions are desperately needed to replace revenues that have been lost because of changes in federal policies.

As spending pressures continue to increase and revenues continue to decline, this balanced budget proposal protects education funding; stresses the importance of quality health care; preserves services for the state's most vulnerable; enhances funding for public safety; strengthens environmental protection; and develops specific tools that will create good jobs for Michigan citizens – all without raising general taxes.

This budget does not sacrifice vital services for the sake of cutting, nor does it spend frivolously on unnecessary services. Governor Granholm's budget wisely cuts spending and responsibly raises the necessary revenue to pay for the critical services the citizens of Michigan deserve. The recommended budget for 2005 is balanced and preserves the high quality of life Michigan citizens desire and job providers expect when deciding where to do business. It is the blueprint for creating a 21st century economy that will create new jobs.

If we are to make Michigan into an economic powerhouse, we must begin now – we must begin with this balanced budget.